IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In re:	)	
	)	Case No. 02-40505
Larry Gene Hagedorn,	)	Chapter 7
Susan Kay Hagedorn	)	
	)	
Debtors,	)	
	)	
United States of America,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adversary No. 02-7033
	)	
Larry Gene Hagedorn,	)	
Susan Kay Hagedorn,	)	
Citizens State Bank of Marysville	)	
Robert L. Baer, Trustee,	)	
	)	
Defendants.	)	

MEMORANDUM AND ORDER

This matter is before the Court on the Trustee's Motion for Summary Judgment, Plaintiff, United States of America's Cross-Motion for Summary Judgment, and Plaintiff's Motion to File a Sur-Reply. The Plaintiff and Defendant Trustee have stipulated to the relevant facts and submitted briefs supporting their positions. Although Debtors Larry and Susan Hagedorn raised the same legal issue in their answer, they have not participated in the briefing. The Court has jurisdiction to decide this matter under 28 U.S.C. § 1334, and it is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B). **I. FINDINGS OF FACT**

According to the stipulation of facts submitted to the Court, the Defendants Hagedorn (hereinafter referred to as "Debtors") began a debtor-creditor relationship with the Farm Service Agency ("FSA"), a

division of the Department of Agriculture, in February 1978, executing a farm ownership loan in the amount of $28,500. In subsequent years, Debtors took out additional loans for farm operation, reamortizing and consolidating as needed. The current debt owed by Debtors to FSA is based upon three promissory notes executed on or about July 11, 1997, totaling $265,091.48, including $138,186.30 plus $21,624.93 in accrued interest for the loan obligations, and $105,280.25 due under a Shared Appreciation Agreement.

Debtors also pledged collateral in favor of FSA, including mortgages on at least two tracts of real estate that Debtors farmed, and a security interest in crops, equipment, livestock, and other farm products. It is the latter property that is at issue here. There is no dispute that FSA's security agreements are properly perfected, and there is also no dispute that there was a cross-collateralization of the notes providing that default upon one note constituted default upon all.

On January 1, 2001, the Debtors defaulted on their loan obligations by failing to make a payment due that date. On May 7, 2001, FSA sent a statutorily required servicing letter to the Debtors indicating that the loan was in default, informing the Debtors of their statutory, regulatory and contractual refinancing options, and warning that inaction would result in acceleration of the loan, legal action to collect on the loan, and other adverse financial consequences. The letter specifically indicated that the agency's purpose, as well as its programs, were meant to figure out a way to let the farmer keep farming, and to help the farmer keep (or find a way to buy back) any farmland that might be subject to foreclosure.

On June 21, 2001, Farm Credit Bank of Wichita filed a mortgage foreclosure action in Washington County, Kansas on one tract of Debtors' land. FSA also had several mortgages on that tract of land, and thus was named as a defendant in the state court proceeding so that clear legal title could be obtained for

ultimate sale by a sheriff. On September 4, 2001, FSA filed an answer preserving its rights to share in the disposition of the proceeds from the sale of the property, to the extent any excess proceeds resulted from a foreclosure sale after payment of foreclosure costs and superior liens. FSA never filed a cross-claim against Debtors, seeking affirmative relief against them, even though by this time, FSA could have accelerated, but had not. On January 14, 2002, the state court granted summary judgment in favor of Farm Credit Bank of Wichita, ordering the Sheriff to sell the property and pay the net proceeds first to Farm Credit Bank of Wichita in the amount of $51,380.02 plus interest, and then, if sufficient funds remained, to FSA in the amount of $138,186.30 plus interest, the total amount of indebtedness due FSA at that time.

Meanwhile, on December 26, 2001, because Debtors had still failed to take advantage of servicing options on its loans, FSA sent another notice to Debtors, threatening to accelerate the outstanding loans, to foreclose on the property securing those loans, and to seek a judgment against Debtors. Even this letter indicated that there were things they could do to avoid acceleration of the notes, and informed Debtors that they would have certain appeal rights, before the agency could actually foreclose, even after acceleration. Debtors did not exercise their administrative rights under that letter, but instead filed for bankruptcy on March 8, 2002. On April 18, 2002, the United States, on behalf of FSA, filed a proof of claim in the amount of $265,091.48, including $138,186.30 plus $21,624.93 in accrued interest for the loan obligations and $105,280.25 due under a Shared Appreciation Agreement.

The Trustee has taken possession of the personal property in which the United States claims to have a perfected security interest. The United States, on behalf of FSA, now seeks reclamation of that property in satisfaction of its lien.

II. SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate if the moving party demonstrates that there is "no genuine issue as to any material fact" and that it is "entitled to a judgment as a matter of law."[1] The rule provides that "the mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact."[2] The substantive law identifies which facts are material.[3] A dispute over a material fact is genuine when the evidence is such that a reasonable jury could find for the nonmovant.[4] "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment."[5]

The movant has the initial burden of showing the absence of a genuine issue of material fact.[6] The movant may discharge its burden "by 'showing' – that is, pointing out to the ... court – that there is an absence of evidence to support the nonmoving party's case."[7] The movant need not negate the nonmovant's claim.[8] Once the movant makes a properly supported motion, the nonmovant must do more

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[1] Fed. R. Civ. P. 56(c), made applicable to adversary proceedings by Fed. R. Bankruptcy. Proc. 7056(c).

[2] *Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 247-48 (1986).

[3] *Id.* at 248.

[4] *Id.*

[5] *Id*.

[6] *Shapolia v. Los Alamos Nat'l Lab.*, 992 F.2d 1033, 1036 (10th Cir. 1993).

[7] *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986).

[8] *Id*. at 323.

than merely show there is some metaphysical doubt as to the material facts.[9] The nonmovant must go beyond the pleadings and, by affidavits or depositions, answers to interrogatories, and admissions on file, designate specific facts showing there is a genuine issue for trial.[10] Rule 7056(c) requires the Court enter summary judgment against a nonmovant who fails to make a showing sufficient to establish the existence of an essential element to that party's case, and on which that party will bear the burden of proof.[11]

III. CONCLUSIONS OF LAW

As a preliminary matter, Plaintiff filed a motion to file a sur-reply in response to the Trustee's motion for summary judgment.[12] The Trustee objected to the motion to file a sur-reply, but nevertheless filed a response to the sur-reply in case the motion for leave to file the sur-reply was granted.[13] A review of the procedure followed by the parties in this case indicates that the pleading Plaintiff denotes a "sur-reply" is actually merely a reply to the Trustee's response to its Cross-Motion for Summary Judgment. Accordingly, because replies to summary judgment motions are allowed, the Court grants the Motion to file the "sur-reply." Accordingly, all briefs filed in support of or in opposition to both summary judgment motions will be considered by the Court.

Plaintiff initiated this action seeking the reclamation of certain personal property in which it claims to have a security interest. The Trustee is objecting to Plaintiff's claim on the basis that a prior state court

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[9] *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986).

[10] *Celotex*, 477 U.S. at 324.

[11] *Id.* at 322.

[12] Doc. No. 25.

[13] Doc. No. 26.

foreclosure proceeding, wherein both Plaintiff and Debtors were defendants, operates as a bar to Plaintiff's present claim seeking recovery of the personal property, under the theory of res judicata. In other words, the Trustee contends Plaintiff was required to accelerate its notes and file an action, foreclosing on the other tract of real estate and all the personal property pledged to it, even though that collateral was not part of the Washington County proceeding.

Plaintiff contends that Kansas law is not applicable in this matter and, even if it were applicable, Kansas law would not operate as a bar to the present claims. Plaintiff also argues that federal regulations precluded it from doing what the Trustee contends was required—affirmatively seeking an in personam judgment, and foreclosing on property not the subject of the proceeding, in the Washington County proceeding. For the reasons set forth below, the Court finds that even if Kansas law applies, Plaintiff's claims are not barred by res judicata.[14]

For res judicata to apply, four conditions must be met: "(1) identity in the things sued for, (2) identity of the cause of action, (3) identity of persons and parties to the action, and (4) identity in the quality of the persons for or against whom the claim is made."[15] A judgment issued by a court of competent jurisdiction is preclusive as to all of the matters actually raised, and those matters which should have been

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[14]Based upon the Court's findings that res judicata does not bar this action, it need not reach Plaintiff's claim that Kansas law is inapplicable on this subject, as doing so would have no bearing on the outcome of this case. However, it appears that the full faith and credit statute, 28 U.S.C. § 1738, would make the Kansas rules regarding res judicata applicable in this case. *See Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 380-81 (1985) (holding that full faith and credit statute required federal courts to apply the rules of res judicata of the state from which the judgment is taken, even if the underlying claim is based upon federal law).

[15]*O'Keefe v. Merrill Lynch & Co.*, 32 Kan. App. 2d 474 (2004) (citing *Jackson Trak Group, Inc. v. Mid States Port Authority*, 242 Kan. 683 (1998).

raised.[16]

Although Kansas law generally forbids the splitting of causes of action,[17] the Kansas Supreme Court has recognized exceptions to this rule. In regard to second mortgage holders, the Kansas Supreme Court has held that the typical rules prohibiting splitting causes of action are inapplicable if the lien holder takes no affirmative action in a case brought by a superior lien holder against a piece of collateral. This exception was explained in *Kearney County Bank v. Nunn*,[18] as follows:

> [T]he holder of a note, secured by a second real estate mortgage, cannot be compelled, even where made a party and served with summons, to file answer and accelerate against his desire his right of action against the mortgagor, simply because the holder of the first mortgage has elected to institute foreclosure proceedings to secure judgment on his debt, sell the property and bar inferior lien holders. The second mortgagee may, under such circumstances, if he desires, permit judgment to be rendered by default against him, thereby raising no issue as to his rights under his note and mortgage *except insofar as they pertain to the status of his lien as against the first mortgagee*. Under such conditions his claim does not become res judicata in a future action. To so hold does not defeat the purpose of the rule for he is protecting the mortgagor from, not subjecting him to, additional litigation.[19]

The exception applies to these facts.

Although the facts in *Kearney* involved a defaulting second mortgage holder, whereas Plaintiff herein actually filed an answer to the complaint in state court rather than allowing default to be entered against it, the rationale cited by the Kansas Supreme Court indicates that the scope of the exception would

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[16]*Id.*

[17]*The Home State Bank v. P.B. Hoidale Company, Inc.*, 239 Kan. 165 (1986).

[18]156 Kan. 563 (1943).

[19]*Id.* (interpreting *Federal Farm Mortgage Corp. v. Bolinger*, 152 Kan. 700 (1940), which found significant that answering party did not cross-petition for affirmative relief against its borrower in the earlier foreclosure action where its second mortgage was at issue) (emphasis added).

cover the facts of this case. Plaintiff did nothing in the state court proceeding beyond securing the "status of [its] lien as against the first mortgagee" as discussed in *Kearney County Bank*.[20] The fact Plaintiff filed an answer rather than allowing default to be entered does not diminish the fact that it was "protecting the mortgagor from, not subjecting him to, additional litigation."

Policy considerations also indicate that this exception to Kansas' res judicata rules apply to these facts. Unlike *Kearney* and the cases it was interpreting, the property at issue in this adversary proceeding consists of personal property. Personal property was not the subject of the state court proceeding; it only involved foreclosure of one tract of real estate. The Trustee's position is that Plaintiff should nevertheless have been required to not only foreclose its interest in the real property that was the subject of the state court proceeding, but also affirmatively sue Debtors on all of the notes that were then in default and foreclose on all of the property that secured those notes. In other words, the Trustee is asking the Court to find that because one mortgage holder sought to foreclose against one tract of Debtors' property, the second mortgage older (here, Plaintiff) is required, within that case, to instantly sue Debtors to obtain an in personam judgment, by filing a cross-petition therein, and to foreclose upon any other real or personal property secured by notes in default, whether they had been accelerated or not. Requiring this additional litigation on property that was unrelated to the initial litigation in no way furthers the policy of res judicata and the prohibition on splitting of claims – which is to prevent additional litigation, not promote additional litigation.

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[20]In its state court answer, FSA did apparently ask the state court to recognize its statutory one-year right of redemption, set forth in 28 U.S.C. § 2410(c). However, FSA was not asking for any affirmative relief in doing so, but merely preserving its statutory rights. Had it not filed an answer, the state court would nevertheless have been required to provide this period of redemption.

The Court also notes that the Trustee's position could have serious negative effects on any farmer's (or other borrower's) prospects for a fresh start, and that equity clearly favors Plaintiff's position. For example, assume that FSA and Debtor have a long-standing business relationship whereby FSA has financed farm operations over the years. FSA has a blanket lien on all tracts of real estate, all farm equipment, livestock, crops, etc., owned by Debtor. If FSA forecloses on real estate, the farmer can no longer farm. Further assume that the Debtor in this scenario is in default on notes to both Plaintiff and to a completely unrelated creditor who holds a superior lien to that of Plaintiff on a single piece of farm equipment, and that the unrelated creditor files suit to foreclose its interest in that single piece of equipment. Under the Trustee's position, FSA would be compelled to file a cross-petition against his borrower, not only to preserve its interest in that one piece of farm equipment, but also to immediately foreclose on all of the other equipment and real estate that was secured by any of the notes held by Plaintiff against that Debtor. Accordingly, although FSA and Debtors were working diligently to find a way to keep the farmer on the farm, the mere fortuity of another creditor bringing an action would require the agency to take affirmative action to take away the farm. It is difficult, if not impossible, to find that Kansas would apply res judicata against Plaintiff in such a scenario, simply because it failed to initiate this further litigation.

The Court finds that even if the Trustee could establish that all four elements of res judicata are met in this case, the exception to res judicata adopted by the Kansas Supreme Court that applies to junior lien holders who do not seek any affirmative relief in the initial state court proceeding is applicable under the facts of this case.

The government has also argued herein that it was barred by federal regulation from filing a cross-petition, seeking affirmative relief, against Debtors in the Washington County case. Although the Court

believes this is likely true,[21] in light of the stipulated facts and the Court's understanding of the regulatory environment in favor of farmers at the time in question, the Court need not address this issue because of its finding that Plaintiff's actions (or inaction) in Washington County does not preclude it from now attempting to foreclose its interest in collateral that was not a part of that state court proceeding.

1. CONCLUSION

The Trustee's motion for summary judgment is based upon a claim that Kansas' rules regarding res judicata bar Plaintiff's claim to the property involved in this adversary proceeding. The Court finds that even if Kansas res judicata rules apply, and the Trustee were able to prove the four required elements of res judicata, the facts of this case place it within an exception to rules relating to res judicata and that Plaintiff's claim is not barred. Therefore, the Trustee's motion for summary judgment must be denied.

IT IS, THEREFORE, BY THIS COURT ORDERED that the Trustee's Motion for Summary Judgment is denied, and the United States' Cross-motion for Summary Judgment is granted insofar as this Court finds that the United States retains a valid and actionable security interest in the farm equipment and products listed in its mortgage with Debtors Hagedorn, and that its claim is not barred by res judicata.

IT IS FURTHER ORDERED that the Motion of the United States to Allow it to File a Sur-reply to the Response of the Chapter 7 Trustee to the Objection of the United States to the Motion of the Chapter 7 Trustee for Summary Judgment (Doc. 25) is granted. The Court will allow the filing of the sur-reply by the Plaintiff and the response by the Trustee.

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[21] *See* Kansas Instructions 1965-A, pages 2-3, attached to the government's memorandum (noting in order for the agency to be allowed to file a cross-claim, all "1951-S" servicing must be complete and the account must have been accelerated) (Doc. No. 23)

IT IS FURTHER ORDERED that because these cross motions only addressed one legal defense raised by the Trustee and Debtors to this action, and did not proceed to the ultimate merits of the case, this Court hereby sets the rest and remainder of this Complaint for a status conference. That status conference will be held **June 9, 2004 at 4:00 p.m.** in Room 215, 444 S.E. Quincy, Topeka, Kansas, and the Court will expect the parties to be prepared to inform the Court whether the resolution of this legal issue results in the ability of the parties to resolve this case, whether additional legal or factual issues need to be resolved, whether discovery is needed, and what the parties believe to be the most expeditious way to resolve this case on the merits.

IT IS SO ORDERED this _____ day of May, 2004.

_____
JANICE MILLER KARLIN
United States Bankruptcy Judge
District of Kansas

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the Memorandum and Order was deposited in the United States mail, postage prepaid on this _____ day of May, 2004, to the following:

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